School for Traders & Investors

Fiftieth Lesson

Are Charts an Aid to Trading?

This Depends on How They Are Interpreted —They May Frequently Be Misleading

FROM students of the market we receive numerous requests for information relative to various phases of stock trading. Some of these inquiries present subjects for discussion which should be of general interest to readers of this department. Such an inquiry is contained in a recent letter from one of our students who writes as follows:

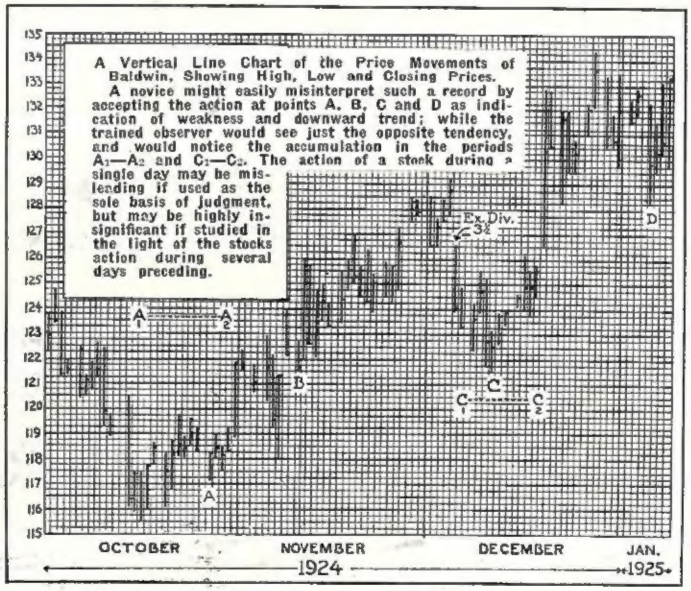
"I have read Mr. Richard D. Wyckoff's book, HOW I TRADE AND INVEST IN STOCKS AND BONDS with great interest. On Page 122, he says that all the out-of-town trader needs is the highest, lowest and last prices of the stocks which he is watching. Would it be asking too much to request further amplification on this point, with examples showing how this may be used in actual trading?

"Of course, if the highest, lowest and last prices of any stock are higher than on the preceding day, we know the immediate trend is up, and vice versa, when these three prices are lower than on the preceding day, the trend is down. But what about the case, which is frequent enough, when the highest price is higher than on the day before, and the lowest prices have gone in opposite directions? On these occasions the closing price will be sometimes higher or lower than it was the day before.

"Therefore we may have a number of combinations of these three prices in which each price will be either higher, lower or the same as it was the preceding day. Mathematically, the number of permutations of three conditions, three at a time, in this case will be 3 x 3 x 3 = 27. Therefore, there are 27 possible combinations of these three prices taken three at a time, and one would have to obtain a good idea of what each one of these 27 combinations might indicate in order to trade intelligently. I would certainly like to see this point explained more fully."

In reply to this inquiry our first impulse is to warn the inexperienced trader not to expect too much from the mere charted record of price movements. No chart tells the whole story, but the record which it presents must be interpreted in the light of such other conditions and facts as may be available, or which may be estimated from the gradual development of the chart itself over a sufficient period of time, and more particularly the major trend of the market.

Our point regarding the interpretation of the kind of chart to which reference is made, is illustrated by a more complete quotation of the very passage which our student has cited. What Mr. Wyckoff said was this: "The out-of-town investor is not under as much of a handicap as he might suppose. If he is trading and can get the result of the day's operation in time to give his orders next morning, he is better off than the majority of the people who come down here and hang over the ticker. His opinions are formed from the facts. *He must know how to assemble these and draw the proper conclusions.* But all he needs is the highest, lowest and last prices of the stocks which he is watching." The italics are ours. The important point is that price changes must be *interpreted.* This can be done with probability of accuracy only if a sufficient number of such changes is available to construct a graphic record that will indicate the general trend of the stock question. Prices for two consecutive days only would be of little if any use in determining trend, for they would not indicate whether the stock was reacting in a bull market, or rallying in a bear market.



A Vertical Line Chart of the Price Movements of Baldwin, Showing High, Low and Closing Prices.

A novice might easily misinterpret such a record by accepting the action at points A, B, C and D as indication of weakness and downward trend; while the trained observer would see just the opposite tendency, and would notice the accumulation in the periods A_1—A_2 and C_1—C_2. The action of a stock during a single day may be misleading if used as the sole basis of judgment, but may be highly insignificant if studied in the light of the stocks action during several days preceding.

Our student is mathematically correct in stating that there are 27 possible situations with regard to the relative position of the three prices, high, low and last. However, he is too hasty in jumping at conclusions. All three price levels mentioned may be lower on a Tuesday than on the preceding Monday, and yet the immediate trend may not be downward, for the closing price may have been reached during the progress of a strong rally following the registration of the low price of the day, at which joint speculators for the decline may have made their final effort just before deciding to cover their shorts. In similar manner we might indicate two possible interpretations for every one of the twenty-seven possible situations suggested by our students.

We wish to point out that the price records must be available over a sufficient period of time to enable one familiar with market operations to place a consistent and reasonable interpretation on the latest changes recorded. It should be clear that no iron-clad rule can be laid down with regard to the determination of the immediate price trend on the basis of high, low and closing prices for two consecutive days only. It is necessary to have the record over a period of sufficient length to indicate a *tendency*

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justified in holding. This is for you to decide.

PENNOK OIL

In Tonkawa Pool

What do you think of the new Pennok Oil shares of which I hold 100 at a cost that may be placed around 20? Do you think the company should be able to profit, particularly during the next year, or would you think it better to switch into something else at this time?—M. J. C., New York City.

The important producing properties of Pennok Oil are located in the Tonkawa Pool. In the past year the company has been very successful in bringing in producing wells, and its present production from this pool is around 9,000 bbls. daily. With the price tendency of oil upward, we consider the outlook for the company satisfactory; but as its production nearly all comes from one locality, it naturally is more speculative than the stock of an oil-producing company whose holdings are more diversified. It is our opinion that by switching to Pure Oil you would reduce your risk and have a stock with just as good prospects for price appreciation. Pure Oil is a complete unit in the oil industry, being a producer, refiner and marketer. Financial condition is sound, and it holds oil lands in the more important producing fields of the United States east of the Rocky Mountains.

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to change. The immediate *fluctuations* may be of little consequence, but a gradually developing *tendency* may be highly significant, and this is the manifestation that our student is really searching for. The accompanying graph will help to illustrate our point.

The student should realize, however, that no rule can be laid down, with regard to charts and records, that will take the place of actual trading experience, involving frequent and repeated interpretation of price changes over a considerable period of time. In stock trading, as in many other lines of endeavor, a little knowledge may be a dangerous thing.